ZIONS BANK® ZBPF PUBLIC FINANCE

MEMORANDUM

DATE: Monday, May 19, 2014

TO: Richard Ellis, State Treasurer
David Damschen, Deputy State Treasurer

FROM: Brain F. Baker
Zions Bank Public Finance

RE: Hawthorn Academy Charter School

The purpose of this report is to document Hawthorn Academy Charter School's ("Hawthorn," "HACS," or the "School") adherence to the eligibility standards created for participation in the Utah Charter School Credit Enhancement Program (the "Program"). The analysis contained herein is based on Hawthorn's full application to the State Charter School Finance Authority (the "Authority"), subsequent conversations with the School's finance team, as well as additional information and documents submitted in response to follow up requests by the Authority.

The School has provided all information requested subsequent to the submission of the initial application. All questions have been answered to my satisfaction. This report will examine each category of the Program's "Standards for Participation," including Basic Eligibility, Enrollment/Student Demand, Academic Performance, Management, Financial Performance, and Bond Documents. In each of these categories, the School met the basic eligibility requirements for participation in the Program, as detailed below. This report should be examined in direct conjunction with the Letter of Certification for Hawthorn Academy from the State Charter School Board ("SCSB Letter"), which provides detailed analysis and historical information on Enrollment/Student Demand and Academic Performance.

<u>Hawthorn Academy—Introduction</u>

Hawthorn Academy is a K-9 charter school located in the City of West Jordan. The School's charter was granted in May, 2008. Hawthorn originally served 710 students up through grade 8 (with a cap of 750). The following year, the enrollment cap was raised to 810 and 9th grade was added. For the last three years the school has been over its enrollment cap, with 811 student enrolled for the 2013-2014 school year. With strong retention and a large waiting list, they should not have a problem maintaining full or near-full enrollment into the future.

Hawthorn's focus and mission has remained constant from their original charter application. The School's three-fold mission statement reads:

"1) to engender a true "love of learning" in our students, 2) to address the needs of the "whole child", and 3) to provide a world-class educational foundation that prepares students for life."

The School plans to issue approximately $16.245 million in revenue bonds to refinance its existing 2010 bonds used to acquire Hawthorn's existing facilities. The financing involves a tender offer to the 3 bond holders of the existing 2010 bonds. Depending on the pricing of the tender offer, debt service savings is anticipated to be between $200,000 and $235,000 per year. No additional funds are being raised from the issuance of the bonds.

Basic Eligibility

1. Hawthorn's 2014 bonds will be issued through the Authority.

2. The SCSB Letter indicates that HACS is in good standing with the State Charter School Board, except for the forecasting of revenues and expenditures. The School has written a letter to address this matter (they missed expenses by 272% in 2010 when they purchased their building), and we consider this a non-issue as it was an extraordinary item not related to the normal revenue and expenditure forecasting process.

3. The School has obtained an investment grade rating of "BBB-" from Standard & Poor's ("S&P"). Key credit concerns from the private rating report are listed below, followed by Zions' response to these concerns :
    a. High pro-forma MADS debt burden of 26.5% based on fiscal 2013 expenditures— debt burden is lowered substantially by the Series 2014 refunding. If the tender offer works as planned, debt burden will fall below 20%.
    b. Limited revenue growth potential because school is operating at capacity—school is in strong financial position that is projected to continue to improve going forward.
    c. Possibility of charter revocation—this is a non-issue.

   S&P also cites the following as positive credit factors that offset the above-listed weaknesses:
    a. Strong demand as demonstrated by consistent full enrollment with "exceptionally strong wait list."
    b. Solid historical EBITDA margins resulting in good pro-forma MADS coverage between 1.5x and 1.6x over the past three years.

    c. Strong unrestricted reserves equal to 127 days cash on hand based on latest audit, and 188 days cash on hand as of the close of fiscal year 2013.
    d. Utah's favorable charter school environment.

4. Hawthorn Academy is in its 5th full year of operations. Financial operating history, as demonstrated by past audited financials, cash position, and increasing unrestricted fund balance, is stable and consistent.

5. The School has a defined and specific mission based on best-in-class curriculum and the International Baccalaureate ("IB") teaching methodology.

6. HACS issued bonds in 2010 which will be refinanced by the 2014 bonds. Hawthorn is not in default under its existing bonds.

Enrollment/Student Demand

7. The School has 811 students enrolled this year.

8. Since opening in 2009, Hawthorn has increased enrollment annually until reaching full enrollment for the 2011-2012 school year, where it has been for the past three years. The "drop" of two students between this year and last can hardly be considered as such since the school has more than full enrollment. Table 1 from the SCSB Letter includes detailed enrollment history back to 2009.

9. Hawthorn Academy exceeds the re-enrollment standard established by the SCSB in each of the past four years (the only years for which this data is available). The most recent total re-enrollment rate of 85%, coupled with the school's strong historical track record, indicate admitted students are generally staying through the final available grade. Table 2 from the SCSB Letter details historical enrollment and re-enrollment.

10. The School exceeds the ADM rate requirement. Over the last three years, HACS's Average Daily Membership rate has been 99.5%, 98.9%, and 96.9%.

11. The School has provided wait list statistics by grade, and has provided the detailed waiting list that includes descriptive and personal information on potential students to the Deputy State Treasurer. The current waiting list is very strong, and includes 1,091 potential students trying for admission in the 2014-2015 academic year. This number should continue to increase through October. The waiting list is strong and includes a substantial amount of students for every grade level offered.

    In addition, re-enrollment statistics by grade level are strong across the board. For the 2013 school year, each grade level had over 84% re-enrollment, with the total for the year at 91%.

Academic Performance

12. The SCSB Letter indicates that the School meets required academic standards. Table 3 from the SCSB Letter provides a breakdown of Hawthorn Academy's performance relative to other schools. It is clear that the school is succeeding relative to other charter schools, and performance improved significantly from 2012 to 2013.

Management

13. The School has adopted reasonable management policies and practices that guide financial, debt, and risk management. The Board has adopted an acceptable Succession Plan as well as a Financial and Risk Management Plan. The post-issuance compliance section of this plan could include a few more specific actions related to compliance.

14. Hawthorn Academy has a reasonably diverse and very stable Board with staggered terms. Though no board member possesses specific legal experience or background, there is clear expertise in management, finance and education.

15. The school has contracted with Academica West as its management company. Academica West has been providing management services to the school since inception.

16. Hawthorn Academy's historical budgeted revenues and expenditures generally demonstrate "reasonable proficiency" in forecasting. With the exception of their building purchase in 2010, both revenues and expenditures have been within 5% each of the last three years.

Financial Performance

The School meets all of the current requirements for the Financial Performance section of the application.

17. Projections used by the School in financial forecasting appear reasonable, and are simplified by the fact that growth in student population is not forecasted or needed. Hawthorn seems well positioned to continue with healthy financial standing. HACS revenues are forecasted to grow at a similar rate to expenses. The School appears to be in a healthy financial position.

18. Debt Coverage Ratio

Requirement	Measure	Sufficient?
At least 105%	166%	Yes

Debt coverage ratio is calculated by dividing total revenues available for debt service by the maximum annual debt service payment anticipated for the new bonds. Revenues available for debt service is calculated by taking fiscal year 2013 net income from operations of $439,249 and adding back depreciation and amortization expense of $367,120 and interest expense of $1,123,273. This leaves net revenues available for debt service of $1,929,642. When this number is divided by anticipated maximum annual debt service of $1,164,131, the coverage is 120%.

For the past three years, this performance has been consistent.

	2013	2012	2011
Net Income Available for Debt Service	$1,929,642	$1,889,479	$1,150,238
Maximum Annual Debt Service	1,164,131	1,164,131	675,500
Debt Coverage Ratio	166%	162%	170%

19. Debt Burden Ratio

Requirement	Measure	Sufficient?
Less than 25%	24.7%	Yes

The debt burden ratio requirement is based on the level of the School's fund balance, which we calculate at 51% (cash of $2,146,193 divided by total operating expenses net of depreciation of $4,192,523). Debt burden ratio is calculated as maximum annual debt service ($1,229,113) divided by unrestricted operating revenues ($4,975,808), taken from 2013 audited financial statements.

	2013	2012	2011
Maximum Annual Debt Service	$1,229,113	$1,229,113	$1,229,113
Unrestricted Operating Revenues	4,975,808	4,899,271	4,582,206
Debt Burden Ratio	24.7%	25.1%	26.8%

The School has not met this requirement in prior years, although the current refinancing will decrease the future projected debt burden ration to approximately 20%.

20. Operating Margin

Requirement	Measure	Sufficient?
At least 7%	39%	Yes

Hawthorn Academy's operating margin requirement of 7% or greater is based on the calculation for days cash on hand (calculated as cash divided by operating expenses multiplied by 365) of 188 days. Operating margin of 39% is calculated by dividing net income available for debt service of $1,929,642 (see calculation under Debt Coverage Ratio) by total revenues of $4,975,808.

	2013	2012	2011
Net Income Available for Debt Service	$1,929,642	$1,889,479	$1,150,238
Revenues	4,975,808	$4,889,271	4,582,206
Operating Margin	39%	39%	25%

21. Current Ratio

Requirement	Measure	Sufficient?
At least 150%	293%	Yes

The current ratio is defined as current unrestricted assets ($2,336,792 for 2013) divided by current liabilities ($798,223). The School has exceeded a 150% current ratio each of the last two years, but did not in 2010.

Hawthorn Academy	2011	2012	2013
Current Assets	1,168,572	1,692,596	2,336,792
Current Liabilities	856,503	780,983	798,223
Current Ratio	136%	217%	293%

Bond Documents

20-23. HACS's legal bond documents have been reviewed by Chapman and Cutler in their capacity as bond counsel to the Authority, and all requirements have been incorporated. In addition, Ballard Spahr, as bond counsel to Hawthorn Academy, has confirmed that each of the required legal provisions is present in the bond documents.